

ALBANIAN INTERLUDE AND BALTIC VISTA 215

destroyed during the war been rebuilt. Nevertheless people gather for prayer and worship even when there is no priest to minister unto them. How implacably the wheels of oppression grind may be deduced from the following comment:

Priests are obliged to pay income taxes in accordance with their rank. Thus a pastor must pay up to the amount of 100,000 rubles annually, and a curate up to half that amount. This means, in the case of a pastor, a sum as large as several of the salaries earned by the most highly paid civil servants. Of course it is impossible for the priests to meet these levies because the faithful, normally earning only a tenth of what it costs them to live, must slowly dispose of everything they own in order to exist. Ultimately the priests must pawn or sell not only everything they possess but also the property of the Church.

Thus broken fane and hunted priest and cowering faithful are symbols of Christianity in our day. What shall we say is the answer that comes from the heart of the West? Is Milosz right when he says that we not only forget about the 500,000 Lithuanians who have been deported to the slave-labor regions of Russia, but fail dismally as well to give our own industrial society dignity and richness? A peasant woman like the writer of the letter he cites must indeed have lived a narrowly circumscribed life. Yet somehow it had a rhythm which, regulated by the seasons, kept the sacredness of the seasons. Who does not occasionally think of the desiccated culture of the West, afflicted with a dry rot which must be in the bones of our education as well as in our social goals? An American, for example, who has observed the lives of so many of his countrymen abroad, veering from reading designed for minds unintelligent and smug alike to entertainment whose sole purpose is to provide a stylized commentary on raw passions, cannot but wonder whether the resources of pseudo-Christianity we fancy we have conserved will suffice for the long and bitter ordeal which lies ahead for us.

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439 tons British. The Niemen is navigable as far as the Lithuanian-
505 Polish 'administrative line', and is used for cargo traffic as far as
361 Kaunas.

361 The administration of the harbour is provided for in an annex to
504 the Memel Statute of 1924, and is controlled by a board consisting
475 of one member appointed by the Lithuanian Government, one by
the Memel Directorate, and one by the League of Nations. Since 1924
noteworthy steps have been taken to improve the technical equip-
ment of the port. The harbour has been extended and deepened,
docks have been excavated, cranes have been installed, and ware-
[457]houses built, the cost, running into 'several tens of millions of lits',¹
being borne mainly by the Lithuanian Government. Some of the
expenditure, however, has been met out of a loan issued by the city
in 1927 amounting to 4,000,000 RM. nominal and offered in Germany.

361 As has already been mentioned, Memel is a comparatively impor-
438 tant industrial centre. Of the 1,056 industrial enterprises in Lithua-
nia employing 5 or more workmen at the beginning of 1937, 137 were
in Memel, and of the 30,561 persons employed in such industries
throughout Lithuania, 8,112 were employed in the Memel Territory.
The more important industries include sawmills, veneer works,
chemical fertilizer plants, and cellulose undertakings. There are also
textile and tobacco factories of some size.

361 Outside the industrial district of the Territory the principal
241 occupation is agriculture. It is impossible to give any indication as
439 to the volume of production, since the figures are included with those
of Lithuania proper. According to the available information, how-
ever, there is normally a small surplus of production for export; and
since the easiest, if not the only, market is East Prussia, the agri-
cultural population of the Territory suffered considerably from the
virtual suspension of commercial intercourse between Lithuania and
Germany owing to the dispute of 1932-5. The Agreement of August
1936 was consequently followed by an appreciable improvement.

361 The Statute of 1924 gives the Administration powers to levy direct
651 and indirect taxation inside the Territory with the exception of
● 652 Customs and excise duties and certain monopolies. The Territory
has a separate budget, which in 1934 balanced at about 14 million
lits. The only funded debt outstanding is the loan of 1927 already
mentioned. Owing to the harbour's international importance, there
is a comparatively large number of commercial and other banks
domiciled in the Territory.

¹ Lithuanian Telegraph Agency (Elta) Service, March 1936.

1[see above, line 12 - - Analyst]

the chaotic conditions of the immediate post-War period were overcome.¹ By 1922 or 1923 it had become possible for all three States to introduce their own monetary units, to institute a régime of *de facto*, if not of *de jure*, stabilization, and to establish a central bank. These operations were achieved largely without the help of foreign borrowing, but the feeling of confidence by which they were followed led to a certain influx of foreign capital which accelerated somewhat towards the end of the period. This, in turn, increased the stability of the new currencies. *De jure* stabilization was effected, the gold and foreign exchange reserves of the central banks gradually rose, and by 1929 it might have seemed that the Baltic States had gone a long way towards solving their currency problems.

Latvia. The first of these States to succeed in stabilizing its currency was Latvia. There was an abortive attempt to establish a Latvian rouble shortly after the Armistice, but the extraordinary conditions of the time, as will be seen, led to inflation and a very rapid depreciation of the currency in the following eighteen months. During the latter half of 1920, conditions became more stable, and the pace of inflation began to slacken. By the spring of 1921 it had become possible to introduce a programme of stabilization.² A new currency, the lat, was introduced, its gold content being fixed at that of the Swiss franc.³ A series of rigid economies in the public expenditure were put into effect. By means of certain monopolies, particularly those of the export of flax and timber, the authorities were able to accumulate a considerable exchange reserve. These measures enabled Latvia to enter on a short period of *de facto* stabilization; and the *de jure* stage was reached on August 3, 1922. Finally a State bank, the *Latvijas Bankas*, was formed and came into operation in November of that year. The share capital is owned entirely by the State, and the bank is defined in its statutes as a State institution though it possesses a certain degree of legal independence.⁴ The reserve for the note issue consists of gold or 'stable foreign currencies', and must amount to 50 per cent. of the first 100 million lats of notes in circulation and 75 per cent. of the next 50 million lats.⁵ The reason why these proportions are so high is that there is a considerable volume of Treasury notes in circulation in addition to those of the bank itself.

Lithuania. The situation in Lithuania immediately after the War 000

¹ For full details cf. von Lehnich, op. cit.

² The successful carrying out of this policy was due largely to M. Kalning, the Minister of Finance, by whose name the programme is usually known.

³ Making a parity of 25-2215 lats to the gold £.

⁴ The position is fully examined in Kisch and Elkin, *Central Banks*, London, 1930, pp. 23-4.

⁵ But see below, p. 174, footnote 2.

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^{Lithuania}
^{Estonia}
Lithuania. The situation in Lithuania immediately after the war was rather different.¹ The currency in circulation at the outbreak of War was the rouble, but with the German occupation Reichsmarks came into circulation. To regularize this position a special institution was set up in 1916 by the German authorities, which issued the so-called 'Oberost' notes in exchange for roubles and marks. But, owing to the conservative instinct of the peasants, roubles tended to be hoarded, and thus the backing for the 'Oberost' money came to be preponderantly German currency. This system was maintained after the declaration of independence, and Lithuania had actually had no currency of her own until 1922, for the authorities continued to issue 'Oberost' notes, which were known as 'Auksinas'. This currency naturally fluctuated with the German mark, and the rapid depreciation of the latter during 1922 made the introduction of an independent Lithuanian currency an urgent necessity. It was finally decided to create the litas, the parity of which was fixed at one-tenth of the U.S. gold dollar,² since this currency was familiar to many Lithuanians, owing to the large number of their compatriots who had emigrated to the United States. The currency came into circulation on October 1, 1922. Simultaneously a bank of issue, the *Lietuvos Bankas*, was established with a gold reserve consisting largely of 3 million gold roubles received from Russia under the Peace Treaty. The bank was granted the sole right of note circulation, one-third of which must be covered by gold. Half of the share capital is held by the State, and provision is made by statute for the exercise of the authority of the State over certain of the bank's activities.

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Estonia. The monetary history of Estonia during the period was rather different from that of the other two countries. This was due to Estonia's credit policy. Shortly after the declaration of independence Estonia began to issue its own currency, the Estonian mark, based roughly on the German mark, of which a great number were then in circulation. The extraordinary needs of the war with Russia led to a steady depreciation, which lasted until about the middle of 1921. But, though the need for extraordinary expenditure such as that required in the previous two years had ceased by 1921, the policy of the Central Bank (*Eesti Pank*), which had been formed in 1919, somewhat aggravated the situation. This bank was a State institution and acted as a bank of issue. But it was also the most important commercial bank of the country, for, during the years 1921-3, the Government endeavoured to restore something of Estonia's former industrial activity by supplying industry with

¹ A full account will be found in Dr. Kazys Sruoga, *Die Wirtschaft der Republik Litauen und ihre Notenemission*, Kaunas, 1930.

² Parity to the gold £ being, therefore, 48-666.

436 working capital through the *Eesti Pank*. Meanwhile, though the
 652 bank was able to keep the mark more or less stable at the rate to
 648 which it had depreciated by 1921, this was effected only at the cost
 of a large proportion of its reserves. This led to a severe crisis in
 the autumn of 1924 and the League of Nations was called in to
 advise.¹

The restriction of credit which followed on this step enabled Estonia
 to maintain the stability of the currency at the depreciated rate. For
 the *de jure* stage of stabilization, appeal was again made to the
 League in November 1926. Their report² recommended the reform
 of the *Eesti Pank*, and the transfer of the long-term assets it had
 accumulated through the Government's earlier industrial policy to
 a specially created Mortgage Institute, both of which recommenda-
 648 tions had been made in the earlier report but had not yet been put
 451 into effect. The League also advised the introduction of a new
 currency. To enable these reforms to be realized an international
 loan was required, and, if the necessary changes were made, the
 League declared its readiness to allow the loan to be issued under its
 auspices.

457 The loan was issued in June 1927, £700,000 in London and
 652 Amsterdam at 94½, and \$4,000,000 in New York at the same price.
 £1,000,000 of the proceeds went to purchase the long-term assets of
 the *Eesti Pank*, which were then transferred, as recommended, to
 648 the newly created Mortgage Institute. Efforts were made by the
 453 League to secure some measure of independence for the Central Bank
 from the State, and the State undertook to sell certain of its shares
 in the bank.³ The scope of the bank's lending operations were strictly
 limited by the new Statutes. It was also granted the monopoly of the
 note issue, and the legal cover, which had previously been such as to
 encourage its commercial operations, was to consist as to not less
 436 than 40 per cent. of gold or 'gold exchange'. Finally, the parity of
 453 the new currency, the Estonian kroon, was fixed at that of the
 Swedish crown,⁴ and the currency was put into circulation at the
 beginning of 1928.

Once *de jure* stabilization was achieved, the stability of these
 currencies was maintained throughout the period without recourse
 to official exchange restrictions. There was also a steady increase in
 the gold and foreign exchange holdings of the Central Banks, though,
 except in Lithuania, there was a tendency for reserves to fall towards

¹ The report of the Financial Committee of the League was issued in March, 1925:
 see League Document C. 240, M. 92, 1925, II.

² *Banking and Currency Reform in Estonia, May 26, 1927*: League Document C. 227,
 M. 86, 1927, II.

³ According to Kisch and Elkin, *op. cit.*, p. 27, a large proportion of its holding was sold
 in 1929.

⁴ Giving a parity to the gold £ of 18-1595.

TABLE 29. *Details of Foreign Indebtedness*

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<i>Latvia (end of 1930)</i> <i>Distribution by creditor countries of nominal</i> <i>(paid up) participation in Latvian joint</i> <i>stock companies</i> <i>(In million Swiss francs)</i>	<i>Lithuania (end of 1933)</i> <i>Distribution by creditor countries of nominal</i> <i>(paid up) participation in, and long-term</i> <i>loans to, Lithuanian enterprises*</i> <i>(In million Swiss francs)</i>
Germany 25.7	Sweden 10.2
Great Britain 16.1	Belgium 8.9
Sweden 11.6	Great Britain 7.2
Netherlands 8.4	Germany 5.3
Belgium 7.3	U.S.A. 2.3
Tsarist Russia 7.1	Netherlands 1.7
Estonia 6.6	Latvia 1.7
U.S.A. 5.3	Others 1.0
Others 16.5	
Total 104.8	Total 38.3

* See *Lithuanian Telegraph Agency (Elta) Service*, February, 1935.

deal of foreign capital invested in banks, though what there is is largely German, and relates principally to the Memel Territory. Of the other industries in which foreign capital has played an important part during this period may be mentioned the metallurgical and leather industries in general; in Estonia the plywood (Venesta Ltd.) and shale-oil industries (New Consolidated Goldfields, Ltd.), and in Latvia and Lithuania the paper industry, British capital being chiefly interested in both cases. Lastly, a Belgian concern is interested in a power station operating in Kaunas.

3. PUBLIC FINANCE

It was some years after the War before order could be established in public finance. Apart from the problem of financing the many extraordinary calls on public expenditure, there were various other difficulties which led to much confusion. Of these perhaps the most serious was the task of creating and developing financial systems where none had existed before. In this the lack of persons with administrative experience was an additional hindrance. Moreover, the monetary chaos of the time made any form of budgeting or accounting extremely difficult. On the other hand, the Baltic States, unlike some of the new countries of Central and Eastern Europe, did not start their existence with a legacy of foreign indebtedness inherited from previous régimes. In the circumstances it was, perhaps, inevitable that there should be a period of currency inflation, though it is sometimes difficult to establish how far these States were themselves responsible for this inflation, and how far it was due to inflation in the countries whose currencies they were using at the time. Towards the middle of this period, however, the need for

- 652 extraordinary expenditure ceased, and in all three countries it became possible to develop systems of public finance on a more orthodox basis. Only in Estonia was it necessary to obtain a foreign loan [56] for this purpose. As a result of the scarcity of capital, the State was often compelled to take over, during the early days, the administration of enterprises which elsewhere would have been left to [439] private initiative. In Latvia, for example, the State took over the entire foreign trade of the country for a period. Most of these extraordinary measures were dropped when more normal conditions returned, though it is hardly surprising that the railways remained in the hands of the State in practically every case.

From about 1925 onwards there was a fairly steady increase in expenditure up to 1928 or 1929. This was largely due to the comparative prosperity of these years, which made it easier to collect the necessary taxation. State expenditure reached a relatively high level in Estonia and Latvia, where the figure per head of the population in 1928-9 (ordinary and extraordinary expenditure) was respectively about 114 and 107¹ Swiss francs. State expenditure in Lithuania was on a considerably lower scale, and the corresponding per head figure in the budget year 1929 was about 59¹ Swiss francs, though Lithuania is exceptional in that expenditure did not reach its peak until 1931. Unfortunately, owing to differences in budgetary systems, it is not possible to attempt a detailed comparative analysis of the various items of expenditure. The largest single item is usually communications, for, apart from the current expenses of running the railways, there were in most cases many repairs arising out of the War which had to be undertaken. Defence usually accounted for about 15 to 20 per cent. of the total. The really striking feature of public expenditure in these years is the comparatively low cost of the debt service, in spite of the funding of debts arising out of the War.² In Latvia and Lithuania interest and amortization usually amounted to less than 2 per cent. of the total ordinary and extraordinary expenditure. Owing to the cost of the League Loan, the figure in Estonia was somewhat higher, though it continued to be under 5 per cent. of the total until 1930-1. The importance of these figures can be seen from the fact that in some of the Balkan States the service of the external debt alone usually accounted for about 20 per cent. or, occasionally even more, of the total annual expenditure by the end of this period.

Expenditure was to a very large extent covered out of revenue, at any rate during the latter half of this period, and in very few instances were there deficits. Where there were deficits they gener-

¹ These figures may be compared with 60.5 Swiss francs for Rumania in 1928-9.

² For details, see p. 135 above.

ally resulted from special capital expenditure, which was to be covered out of loans raised for this purpose. This, for example, was the cause of Latvia's deficit in 1928-9, which was covered out of the proceeds of a loan contracted with the Swedish Match Company.¹ In Estonia, on the other hand, every fiscal year from 1922 to 1930-1 closed with a surplus. In general it is clear that, in the few cases where loans were obtained by the State during this period, the proceeds were allocated, to a very large extent, for capital expenditure of one sort or another, and were not used simply to bridge gaps between ordinary revenue and expenditure.

The difficulty of collecting direct taxes in peasant countries such as the Baltic States is considerable. It is not surprising, therefore, that only a small proportion of the public revenue is obtained from such sources: ⁶⁵¹

TABLE 30. *Sources of Public Revenue*

<i>Fiscal year</i>	<i>Estonia 1922-9 (mill. kr.)</i>	<i>Latvia 1922-9 (mill. lats)</i>	<i>Lithuania 1929 (mill. lts)</i>
1. Total ordinary and extraordinary revenue	92.2	184.9	290.3
2. Total direct taxation	7.7	13.0	37.8
3. Percentage of direct taxation	8.3%	7.0%	12.9%

As regards the other sources of revenue, the most important was generally the Customs duties which, in the years referred to in the above table, amounted to 22.6 per cent., 33.1 per cent., and 20.6 per cent. of the total ordinary and extraordinary revenue, respectively, for Estonia, Latvia, and Lithuania. Apart from this, the chief items of revenue were the alcohol or spirit monopolies, which were held by the State in all cases during this period, and the receipts from the State forests. The railways do not appear to have yielded any very great net revenue to the State during the period.

In general, the finances of these States were soundly and successfully administered during most of the years here considered. The general level of expenditure, though high when compared with that of certain Central and East European countries, was not excessive. Public finance was not overburdened with a heavy interest charge. There was no extravagant borrowing at home or abroad. The level of taxation, so far as can be seen, was by no means intolerable. But, as with all countries which primarily produce raw materials, this favourable position largely depended on the maintenance of the existing level of prices; and, if they began to fall, it was clear that drastic changes would occur. Moreover, it has been seen that even during the present period there were several instances where the ⁶⁵²

¹ See above, p. 135.

- 652 State had begun to encroach upon the field of private enterprise. The implications of this movement will become clear when the period after 1931 is considered.

4. THE BANKING SYSTEM

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Before the War banking had been fairly highly developed in Estonia and Latvia. The centre of the system, however, was naturally St. Petersburg. There was a considerable number of commercial banks in most of the more important towns of the Baltic Provinces, mostly with head offices in that city. Indeed, it was a frequent complaint that the commercial banks invested an excessive part of the deposits which they drew from the Baltic Provinces in other parts of the Empire. These banks were largely concerned with the foreign trade conducted through Riga, Reval, and the other large ports and, to a lesser extent, with the financing of industry. In addition, since the beginning of the century, the Russian authorities had done something to foster the growth in all three countries of mortgage institutes for local requirements, and of municipal banks. The mutual credit association, also, was beginning to become popular.

The War, of course, destroyed this system. Liquid assets held in the branches were withdrawn to the head office, records were destroyed, and finally, in many cases, the parent institution ceased to exist. But the system left its mark on the Baltic States. For, when these States began to develop banking systems of their own, an unusually clear distinction was drawn between the function of the commercial banks and that of the other units of the system. Banking during this period grew up largely on the principle of the specialization of functions; and, even in Lithuania, where financial technique is less developed than in the other countries, there is a comparatively large number of categories of banks. Thus, in addition to joint stock commercial banks proper, there are usually to be found private banks, rural and urban credit institutions, mutual credit associations, and municipal banks, apart from the banking apparatus of the co-operative system.

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In spite of this diversity of types, there is nothing in the Baltic States which corresponds to a money market, and the credit system is directly dependent on the central bank. This usually tended to render credit expensive, and during most of this period the rate of interest was considerably higher than in Western Europe. It would certainly have been higher still but for the fact that the investments of foreign banks in the commercial banking systems of the Baltic States were substantial, and foreign credits were therefore easy to obtain at comparatively cheap rates. This, together with the return of more normal conditions after the War, led to a noteworthy expansion of

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Mortgage Credit. In all three countries the Government took steps shortly after the War to provide machinery for granting mortgage loans to farmers and others. The proceeds of the loans were used largely for purchases of stock, plant, and agricultural machinery, and for the reconstruction of buildings destroyed in the War. The Latvian Government established a State Land Bank in 1922 to grant mortgages on agricultural land, and two years later a State Mortgage Bank for financing similar requirements in urban districts. In Estonia the State also formed a Land Bank in 1926 for issuing agricultural mortgage loans and, in 1928,¹ a National Mortgage Bank to take over certain long-term assets of the Central Bank; the new institution also made long-term loans not only to farmers but to industrialists, ship-owners, and co-operative societies, and, for house-building, to private persons. The Lithuanian Government formed a Land Bank in 1924 for issuing mortgage loans to farmers. In all these cases the rate of interest charged was high compared with rates in Western Europe.

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Credit Co-operatives and Other Institutions. The application of the co-operative system to agriculture and dairy farming led to a very considerable growth of co-operative credit institutions, especially in rural districts. The ground had been prepared before the War by the growth, chiefly since the beginning of the century, of mutual credit associations, and many of these were absorbed in the new credit co-operatives, though there still exists a substantial number of mutual credit societies in the Baltic States. Though the number of institutions is large, the individual credit co-operative is small, but in Estonia and Lithuania means were provided for helping the smaller institutions, as well as the large, by the foundation with State assistance of a co-operative central bank. There is still a small number of municipal banks in Estonia and Latvia. These institutions originated in Tsarist days with the municipal banks, whose liabilities were guaranteed by the municipality.

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Insurance. In Latvia the number of insurance concerns is large; there were in 1935 about 470² institutions, though most of these were small local businesses. Most of the larger risks insured relate to shipping and foreign trade. There is also a State insurance department which apparently competes with the ordinary commercial concerns.³ Foreign insurance businesses are not allowed to operate in Latvia. There is a considerable insurance business in Estonia but less highly developed than in Latvia. That of Lithuania is still less developed, though foreign, chiefly German, capital here played some part during the period.

¹ See above, p. 133.

² D.O.T.: *Economic Conditions in Latvia, January 1935*, publ. 1935, p. 7.

³ For later developments, see below, p. 185, footnote 3.

PART II. THE CRISIS OF 1931 AND SUBSEQUENT DEVELOPMENTS

INTRODUCTION

THE economic system built up by the Baltic States during the period ⁴³³ which ended in 1930 was highly sensitive to tendencies in the outside world. In other words, the system depended very largely on the maintenance of prices at or around the levels of the years 1925-30, and still more on the ability of the chief markets to continue to absorb Baltic exports. The system also presupposed that foreign capital would be available to finance foreign trade and, eventually, the larger schemes of development for which money was lacking at home.

The crisis of 1931 swept away these assumptions. There was first ⁴⁵⁸ a catastrophic fall in the price of all the commodities produced by ⁴³⁹ these States. Simultaneously the principal markets, the United ⁴⁵⁷ Kingdom and Germany, began to restrict their imports from the Baltic countries. The result was a considerable fall both in the exchange available for imports and in the exchange reserves held by the Central Banks. This led, in turn, to the imposition of exchange restrictions and, in Estonia and eventually in Latvia, to the abandonment of the currency parities introduced after the War. Meanwhile, in order to save foreign exchange, imports had to be reduced to a small fraction of the figures attained before the crisis, with a consequently severe effect on the whole productive system. Finally, budgets were thrown into deficit and there was a general ^[452] increase in public internal indebtedness. ●

During the years which followed 1931 the Baltic States have been adjusting themselves, gradually, and on the whole with a considerable degree of success, to the new conditions which have since prevailed. The process of adjustment has been immensely assisted by the fact that, unlike most of the States of Central and Eastern Europe, the Baltic countries did not accumulate an excessive amount of foreign indebtedness in the years before the crisis. On the contrary, one of the chief differences between the effect of the crisis in the Baltic and that in the Balkans, for example, is that none of the Baltic States has defaulted on its foreign debt.

For countries as small as the Baltic States, a policy directed towards ⁴³³ the greatest possible isolation from the outside world—such as that pursued by Italy or Germany—was obviously out of the question. Nevertheless, the adjustment has been accompanied by a complete reorganization of the productive system. Estonia and Latvia, in order to economize exchange, have increased their production of cereals, which, as a general rule, they now no longer import. Latvia

TABLE 32. *Price Movements in the Baltic States,¹ 1931-7*

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(1929 = 100)

		Estonia	Latvia	Lithuania
Average for year 1929	.	100.0	100.0	100.0
" " 1930	.	87.2	85.0	86.6
" " 1931	.	77.8	70.7	74.2
" " 1932	.	70.9	71.0	60.9
" " 1933	.	72.6	69.8	53.6
" " 1934	.	72.6	69.2	51.5
" " 1935	.	71.6	72.6	46.4
" " 1936	.	77.8	75.6	46.4
" " 1937	.	86.3	94.2	52.6

articles they produce. The price of the staple agricultural products, in fact, often fell far more heavily than is suggested by these figures, while that of the manufactured goods used by the farmers fell more slowly; and the Baltic farmer was very severely affected by this opening of the 'price-scissors'. Moreover, the index figures are misleading in the case of Estonia and to some extent in that of Latvia, owing to the abandonment of the gold standard during 1933 in the former country, and in the latter to the adoption of certain measures equivalent to the recognition of currency depreciation,² before the gold standard was abandoned in 1936. If, for example, the index figure for Estonia in 1934 were adjusted so as to allow for the depreciation of the currency, it would stand not at 72.6 but at 45.1.

The chief effects of the fall in prices upon the agricultural classes were a heavy increase in the service of their debts, which had been contracted for the most part when prices were considerably higher, and an increasing difficulty, amounting often to impossibility, in purchasing manufactured articles. In Estonia and Latvia the State was able to assist the farmer to some extent. Thus in 1933 the State Mortgage Bank of Estonia reduced the rate of interest on loans contracted before October of that year from 8 to 6 per cent., while in March 1934 part of the debts of certain small farmers to the State Agricultural Bank were cancelled, and the service of certain other such debts was suspended until 1937. At the same time service on the debts of certain small debtors to the State Mortgage Bank was remitted for a similar period.³ In both countries measures were taken, more or less successfully, to maintain agricultural prices, e.g. the subsidies offered on rye and wheat or the export premiums granted for bacon, butter, and eggs. Moreover, the increase in grain production encouraged by the

¹ Estonia and Latvia: wholesale price indices, taken from League of Nations, *Monthly Bulletin of Statistics*. Lithuania: *Lietuvos Bankas Bulletin*, February 1938 (no. 15 [39]), 'commodity price' index (1926-9 = 100) adjusted with 1929 as base year.

² See further p. 174.

³ League of Nations, *Memorandum on Commercial Banks, 1929-1934*, Geneva, 1935, p. 72. For the banks here mentioned, see above, p. 142.

435 Governments of these two States did much to compensate the agricultural class as a whole for falls in the price of their staple products. 652 No such policy was possible in a country such as Lithuania, where 565 agricultural production could not readily be increased. Here the situation was aggravated by the economic difficulties with Germany arising out of the Memel question,¹ and the position of the peasant [511] long remained miserable. It was stated in November 1935 that 'in spite of all the relief afforded directly and indirectly by the Government, farmers are thrown back on their own resources, even to the wearing of home-spun cloth and straw shoes'.²

485 Since 1935, however, prices have risen appreciably in all three countries, and even in Lithuania, where the gold content of the currency has remained the same throughout, the increase has been substantial. The rise gathered momentum during the earlier part of 1937 and, though most prices have since fallen somewhat, the [434] effect upon the position of the farmer has been enormous. The resulting increase in the purchasing power of the agricultural population has, in fact, been the basis of the active industrial conditions which persisted in Estonia and Latvia during 1936 and 1937-8, and of the considerable increase in Lithuania's imports in 1937, most of which are of an industrial nature.

3. AGRICULTURE

243 The production of cereals over the period is shown in the following 433 table:

TABLE 33. *Cereal production*

	Area under crop (thousand ha.)				Production (thousand quintals)				Yield (quintals per ha.)			
	Average 1926-30	Average 1931-5	Year 1936	Year 1937*	Average 1926-30	Average 1931-5	Year 1936	Year 1937*	Average 1926-30	Average 1931-5	Year 1936	Year 1937*
<i>Wheat</i>												
Estonia	30	56	66	68	331	634	663	753	10.7	11.3	10.0	11.1
Latvia	61	119	129	137	731	1,633	1,435	1,718	11.8	13.7	11.1	12.8
Lithuania	163	205	196	309	1,859	2,532	2,189	2,174	11.9	12.4	11.0	10.4
<i>Barley</i>												
Estonia	114	107	101	89	1,139	1,034	868	819	9.9	9.7	8.6	9.2
Latvia	176	185	189	182	1,570	2,004	1,650	2,814	8.8	10.6	8.7	12.0
Lithuania	201	202	214	214	2,113	2,435	2,336	2,471	10.7	12.1	10.9	11.6
<i>Rye</i>												
Estonia	143	147	137	149	1,594	1,907	1,535	2,059	12.1	13.0	11.2	13.8
Latvia	254	253	268	288	2,471	3,146	2,860	4,314	9.7	12.4	11.1	14.6
Lithuania	471	495	492	510	5,184	5,691	5,414	6,009	10.8	11.4	11.0	11.8
<i>Oats</i>												
Estonia	144	143	138	145	1,273	1,409	1,138	1,437	8.6	9.9	8.2	9.9
Latvia	297	317	339	335	2,561	2,843	2,844	4,049	8.0	11.2	8.4	12.1
Lithuania	335	350	357	348	3,370	3,735	3,316	3,898	9.4	10.7	9.3	11.2

* 1937: provisional figures only.

¹ See below, p. 167.

² D.O.T.: *Economic Conditions in Lithuania, November 1935*, publ. 1936, p. 24.

working for export, especially the timber and plywood industries. 478
This was followed by a general decrease of activity throughout the 423
industries supplying the home trade, such as the textile industry,
owing to the fall in agricultural purchasing power arising out of the
decrease of exports. This movement was further accelerated by the [451]
credit crisis of 1931 and the moratorium on banking withdrawals;
and by 1932 the monthly average total of unemployed was well over
14,000.¹

Meanwhile, in the autumn of 1931 there was a general increase in 178
Customs duties, and a system of import quotas and exchange restric- 433
tions was introduced. All these measures greatly increased the 457
tendency towards industrial self-sufficiency, which now became the
acknowledged policy of the Government. There was consequently a
considerable increase in the activity of the consumption industries,
especially the textile sections, which, as in Estonia, increased their
consumption of home-grown flax. This led in turn to an increase of
activity in the production goods industries. At this stage the export
industries began to experience a recovery, and by the end of 1934
the building boom in the United Kingdom began to have an appreci-
able effect on the plywood industry and saw-mills. There was also a
marked recovery in the paper and cellulose industry.

Up to this point industrial expansion had followed the normal 458
course of recovery from a severe recession. This recovery had taken 471
place for the most part within the limits of the existing industrial 185
apparatus. Few fresh industries had been started, and the relations
existing between industry and the State before 1930 had, for the most
part, been maintained. The advent of the totalitarian system in
1934, however, has been followed by an entirely new industrial
policy. This policy does not consist merely in an attempt to attain
the greatest degree of self-sufficiency. Its purpose would seem rather
to be the introduction of a form of State capitalism or, at any rate,
a system in which the State is able to exert direct control over the
industrial organization. It will be seen how the State, by its relation
to the co-operative system, is able to exert a considerable degree of
control over agriculture and dairy farming. This, however, is a policy
which the State is generally compelled to pursue in a poor country of
small farmers. That such a policy should be applied to a relatively
large industrial organization, which had hitherto relied on private
enterprise, was a considerable innovation.

The policy began to be put into effect first through the *Latvijas* 471
Kreditbanka,² a commercial bank formed by the State in 1935. 452 ●
By the purchase of majority shareholdings, this organization soon 655

¹ I.e. demands for work according to the official returns.

² On this, see further pp. 184-5.

Latvia
Lithuania

471 acquired a considerable interest in industries of a very varied nature, in determining the policy of which it is naturally instigated by the desires of the State. During 1936 and 1937, however, the State itself has been acquiring a direct shareholding interest in a number of concerns, of which may be mentioned a large metallurgical works in Riga, and a large brick factory. Even in the timber industry the Government is in a position to control auction sales, and is itself an exporter. Almost the only branch of industry which has so far remained free from the direct or indirect influence of the State is the textile manufacturing industry.¹ How far this policy will be pursued

[195] it is impossible to say. The President stated in April 1937 that the Government wished the entire Latvian population to participate in the progress of industry by taking a direct shareholding interest, and appealed to the public to purchase shares in the new State brickworks, even suggesting that the State might guarantee dividends.

433 *Lithuania.* Developments in Lithuanian industry since the crisis have been on the whole inconsiderable. Though severe restrictions were placed on imports in 1935, the existing industrial system was too small to bear the strain of a thoroughgoing policy of self-sufficiency, and, in any case, the lack of foreign exchange and foreign credit has prevented the import of sufficient plant to make it possible. Nevertheless, there has been some expansion in the textile industry since 1930, and in 1936 there were as many as 5,000 persons employed in this branch, though the figure includes those employed in Memel. The result has been some decrease in the import of textile piece goods and an increase in the import of yarns and raw materials.

[477] A further development of some importance has been the growth of trusts and combines, mainly in the foodstuffs and brewing industries, which have arranged for the regulation of output and the fixing of prices.²

II. FOREIGN TRADE AND BALANCE OF PAYMENTS, 1931-7

1. GENERAL MOVEMENT

439 It has been seen that the foreign trade of Estonia and Latvia had already begun to decrease before 1931. With the onset of the financial crisis of that year, the decrease in the trade of all three countries rapidly gathered momentum. The value of exports (expressed in Swiss francs) did not finally reach their lowest level until 1933 for

¹ The State, however, has recently taken an interest in a newly formed company concerned with the production of woollen textiles (*Frankfurter Zeitung*, August 21, 1937). It may be added that the State is interested also in shipping; see below, Appendix II, p. 191.

² Details are given in D.O.T.: *Economic Conditions in Lithuania, November, 1935*, publ. 1936, pp. 15-16.

III. THE FINANCIAL SITUATION

1. THE EXCHANGES AND MONETARY POLICY, 1931-7

The general principle upon which currency stabilization had been effected in the Baltic States was, briefly, that central banks should hold gold or foreign exchange reserves sufficient to offset any temporary adverse movements in the balance of payments which could not be covered by capital imports. These reserves were naturally not large enough to meet withdrawals of foreign capital on a large scale; and it cannot be said that they were intended to be. By the end of 1930 it had become impossible to import capital owing to conditions on foreign money markets. Moreover, the reduction of foreign trade was leading, as has been seen, to serious deficits in the balance of payments. The German crisis, which began in July 1931, was followed in the Baltic States by an entire loss of confidence, and to some extent by a withdrawal of German and other foreign capital, leading quickly to a considerable amount of domestic withdrawals. Finally, the collapse of sterling in September of that year led to conditions bordering on panic, for in Estonia, and to a smaller degree Latvia, the foreign exchange reserves of the Central Banks had been held largely in sterling, and to that extent were reduced proportionately with the fall of the pound.

All these events struck at the very principle upon which the Baltic currencies had been stabilized, but the policy adopted to meet them has varied considerably from country to country. In Estonia and Latvia official exchange restrictions were adopted in the autumn of 1931; but Lithuania was able to avoid this step until 1935. Again, Estonia decided to abandon the gold standard and join the sterling bloc in the summer of 1933, but Latvia did not follow her example until September 1936, while in Lithuania the external value of the currency has been maintained at the same level ever since the stabilization of 1922. Lastly, the general improvement in world economic conditions since 1933 has been reflected very differently in the currency systems of these three States. It will therefore be necessary to examine the position in each country separately.

Estonia. In Estonia exports had tended to decrease since 1928, but imports had been reduced, and there was a comfortable surplus of merchandise exports in 1931. Invisible exports also exceeded invisible imports in that year. It might therefore be asked why a currency crisis should have arisen at all. The answer would be that it was largely a crisis of confidence. The German catastrophe of July 1931 had been followed by withdrawals of German capital, and a flight from the kroon by Estonian nationals. Moreover, a large proportion of the *Eesti Pank's* foreign exchange reserves consisted of

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652 sterling, and the loss on the abandonment of the gold standard by
457 Great Britain was considerable. Even before 1931 these reserves had
458 been allowed to fall to a low level, and it was clear that, if sterling
continued to depreciate, they would soon fall below the minimum
required for safety.

At this stage the alternatives before Estonia were to abandon the gold standard like the Scandinavian countries—the kroon, it will be remembered, was based on the Swedish crown—or to impose a system of exchange control. Estonia, however, had not sufficient resources to justify taking the chances with her currency which the former alternative seemed to involve, especially in the uncertainties prevailing during the autumn of 1931. Moreover, the abandonment of the gold standard, it was felt at the time, might lead to currency inflation, the disastrous effects of which Estonia had already experienced once. It is not surprising, therefore, in the circumstances, that unofficial exchange restrictions were introduced early in October, though official control of the exchanges was not put into effect until November 19, 1931. The restrictions were constantly made more rigid throughout the year that followed. With their help, and that of the increased restrictions on exports, the gold value of the currency was maintained at its legal level.

It gradually became clear, however, that this was a somewhat empty achievement. The example of Germany was beginning to show the difficulties to which exchange control leads. Moreover, maintenance of the original value of the kroon penalized Estonia's exports to Great Britain, and placed her in a poor position to compete with other exporters of dairy produce and timber in countries which had depreciated their currencies. It was gradually recognized, therefore, that a mistake had been made. In December 1932 it was decided to impose an *ad valorem* tax of 15 per cent. on sales of foreign exchange to importers, &c., the proceeds of which were allocated to a fund established for subsidizing exports. The depreciation of the dollar in March 1933 considerably lightened the burden of Estonia's foreign debt, and it thus became possible to go even farther. On June 28, 1933, the gold standard was abandoned, and the external value of the kroon was reduced to that of the Swedish crown, involving a depreciation, at that stage, of about 35 per cent. Finally, during the following autumn it was decided to base the external value of the Estonian kroon directly on that of sterling, with which currency the kroon has since fluctuated.¹

¹ According to the League of Nations *Memorandum on Commercial Banks, 1935-6*, Geneva, 1936, p. 74, the gold held by the *Eesti Pank* at the time of the abandonment of the gold standard, viz. 19 million kroon, has not yet been revalued. A substantial profit should eventually accrue to the State therefrom.

There is little doubt that the general improvement which followed was due to the abandonment of the gold standard. Wholesale prices began to rise appreciably enough to give some relief to producers, but not sufficiently to offset the effect of currency depreciation on foreign trade, for the value and volume of exports, especially to the United Kingdom, began to increase almost immediately. Lastly, as will be seen from the table at the end of this section, the exchange reserves also began to improve, and it was possible to relax the exchange restrictions considerably. It is true that restrictions are still in force, but their main purpose is to prevent the export of capital and the import of goods not considered to be essential to Estonia's economy; and they do not at present interfere very greatly with normal commercial transactions.

Latvia. In Latvia the decrease of foreign trade between 1929 and 1931 was very considerable, but the current items of the balance of international payments showed a surplus both for 1930 and 1931. As in Estonia, the extraordinarily severe financial crisis of the latter year was largely a crisis of confidence. The withdrawals of capital arising out of the German banking crisis of July were even heavier in Latvia than they were in Estonia, and there was an alarming decrease in the gold and foreign exchange reserves of the Central Bank. The amount of withdrawals, both foreign and domestic, was so large that regulations were introduced in the middle of July 1931 imposing strict limits on the proportion of deposits which might be withdrawn.¹ These difficulties were greatly increased by the abandonment of the gold standard in the United Kingdom, much of Latvia's exchange reserves being in sterling, and on October 8, 1931, a system of exchange control was introduced.

Although the banking moratorium was gradually relaxed, the severity of the exchange restrictions was constantly increased, and their scope was considerably widened. This process continued until 1935, and though, as will be seen, the currency was virtually allowed to depreciate in that year, the nominal gold parity was maintained up to September 1936. Since the economic structure of Latvia so closely resembles that of Estonia, which had abandoned the gold standard in June 1933 and greatly profited thereby, the question will arise why Latvia did not follow Estonia's example. It should, however, be pointed out that Latvia had experienced a severe credit crisis, whereas Estonia had not; and that this greatly intensified the common fear that the abandonment of the gold standard might be followed by a currency inflation similar to that of the period immediately after the War. Moreover, before the crisis, Latvia, unlike Estonia, had an habitual surplus of merchandise

¹ On the banking moratorium in Latvia, see further pp. 184-5.

1: Anonymous U-4 (no date) 1938 RBl Baltic States ^{Latvia} R87

457 imports, and it was felt, not without some justification, that until
● 652 this import surplus had been converted into an export surplus, or
458 at any rate substantially reduced, experiments with the currency
would be inadvisable.

Whatever the reasons for Latvia's choice, its effects are plain. The Government was gradually led by the consequent deflation to extend the control which it now exerted over exchange movements, not only to almost every branch of production and trade, but to the credit system as well,¹ and to follow an economic policy very similar to that pursued by Germany for the same reasons. But it was clear that, though this system enabled the Government to maintain that the nominal gold parity of the lat was unaltered, it did nothing to improve foreign trade, and Latvian exports to Great Britain met with considerable competition from Estonia. The Latvian exchange policy was, consequently, modified so as to assist exports. The change took the form at first of a direct subsidy to exporters of the principal export commodities, such as butter. During 1935, however, a new system was introduced whereby the exporter received a premium in lats over the official price given by the control authorities for the exchange produced by his exports, and the importer had to pay a similar premium for the exchange required to pay for his imports. This premium at times rose to as high a figure as 35 per cent. In other words, the Government were virtually forced to admit that the external value of the currency had depreciated by roughly 25 per cent.

Nevertheless, although this admission was of some value to Latvia's foreign trade, the system introduced in 1931 was maintained until the end of September 1936. The almost simultaneous devaluation of the French and Swiss francs and the depreciation of the Dutch guilder gave the Latvian Government the opportunity of openly recognizing the depreciation in the external value of the lat without losing prestige.² On September 28 a law was passed fixing the parity of the lat at 25-2215 to the £, the parity existing before Great Britain abandoned the gold standard.³ Since sterling has no fixed value in gold, this step on Latvia's part was equivalent to the abandonment of the gold standard; and from that date the lat has belonged, like

¹ On this point see further, p. 185.

² The difficulty of adhering to the currency policy which Latvia had chosen was shown shortly before the devaluations of September 1936 gave her this opportunity. In July 1936 it had become necessary for the Government to reduce the gold and foreign exchange cover for the note circulation from 50 per cent. to 30 per cent. of the total note issue, provided that the latter was less than 100 million lats. *Frankfurter Zeitung*, July 16, 1936.

³ An exchange equalization fund was established in November 1936, to which was allocated some of the profit arising out of the writing up of the value of gold in the hands of the Government and the *Latvijas Banka*. Exactly how much of the profit was so used is not known.

the Estonian kroon, to the sterling bloc. The exchange restrictions, however, have not been notably relaxed, and it is still necessary for Latvian importers to obtain an import licence, which usually carries with it a permit to receive exchange, though in practice the restrictions now interfere little with normal commercial transactions.

Lithuania. In Lithuania the immediate effects of the general financial crisis of 1931 were less severe than in the other two countries. The extent of foreign investment in the banking system was smaller, and the withdrawals which took place were not sufficient to lead to any great loss of confidence in the currency. Moreover, the loss on the abandonment of the gold standard in Great Britain was not so large as in Estonia or Latvia, for the gold reserves of the Central Bank were chiefly held in dollars and not in sterling. Thus, although the fall in the volume of foreign trade had been considerable, and there were some domestic withdrawals from the banks, there was no serious flight of capital. Large exports of capital did not, in fact, begin to take place until 1935, and it is significant that, though the current items of the balance of payments had led to an unfavourable balance in 1931 and 1932, and there was a corresponding decrease in the gold and foreign exchange holdings of the *Lietuvos Bankas*, official exchange restrictions were not introduced until October 1935. The inference must be, it would seem, that the reserves accumulated year by year up to 1930 were sufficient to offset current adverse movements, but not to cover a heavy export of capital.

The sudden deterioration of the position in 1935 was largely due to extraordinary causes. The dispute with Germany over Memel, as has been seen, led to an almost complete suspension of commercial intercourse with what had been Lithuania's best customer. Moreover, the increase of emigration to Palestine was responsible for capital withdrawals on a fairly considerable scale. Thus, though the Central Bank had avoided a loss on the devaluation of the United States dollar in 1933 by converting most of its dollar holdings into gold or other currencies before the dollar was devalued, its gold and foreign exchange reserves continued to decrease. By the end of September 1935 the margin above the 33½ per cent. required as cover for the note issue was negligible, and on October 1 exchange restrictions were at last introduced. With their help the original gold parity of the litas has since been maintained.

It will be asked how this has been possible during a time in which Lithuania's chief competitors in the export market had the advantage of a depreciated currency. The reply seems to be that in Lithuania the fall of prices was greater than in the other two countries, and that,

457 so far as exports are concerned, this offset some of the advantages
 652 gained by Estonia and Latvia through currency manipulation.
 458 Moreover, most exports have gradually been brought under the
 control of Government agencies, direct or indirect, and in some cases,
 e.g. butter, considerable subsidies have been granted. Lastly, the
 standard of living is considerably lower in Lithuania than in the other
 two countries, and in Lithuania the peasant is perhaps readier than
 in Estonia or Latvia to accept the lower prices which he must ask if
 his goods are to compete in world markets. But, though Lithuania
 has thus been able to make the best of both worlds by retaining her
 share of the foreign market, and at the same time adhering to the
 gold standard at the old level, the situation is clearly artificial, and
 the fact that it is necessary to subsidize exports indicates that the
 claim that the old parity of the litas has been maintained is not
 strictly correct. It is therefore surprising that Lithuania did not,
 like Latvia, seize the opportunity to recognize the *fait accompli* in
 September 1936. But, both then and since, the Government has
 insisted that there will be no change in their currency policy, and
 meanwhile the restrictions have been maintained. No difficulties,
 however, have been made by the authorities up to the present in
 supplying foreign currency for legitimate commercial transactions.

Developments during the period can be seen from the table
 opposite.

2. PUBLIC FINANCE

652 The budgetary position of all three States was, of course, severely
 affected by the crisis. The fall of agricultural prices rendered the
 collection of taxes difficult, and the general decrease in activity led
 also to a decrease in the revenue from indirect taxation, particularly
 from import duties. Ordinary expenditure, on the other hand, could
 not always be reduced *pari passu* with revenue, and, though very
 considerable economies were made, budgets were thrown into deficit.
 At the same time, though extraordinary expenditure was greatly
 reduced by the suspension of expenditure on public works, the State
 was obliged to spend considerable sums, usually outside the budget,
 on assisting the economic system by subsidies and other similar
 measures. During the last year or two, however, the increase of
 activity has led to a considerable improvement in ordinary budgets.
 But with this improvement there has been no reduction of the direct
 interest which the State had taken during the crisis in various
 branches of economic activity. On the contrary, the direct part thus
 played by the State has considerably increased in importance, at any
 rate in Estonia and Latvia, though the relevant figures do not always
 appear in the budgets.

TABLE 51. Position of the Exchanges

	Exchange Reserves of Central Bank in millions (at end of year)			External value of currency expressed as a percentage of gold parity (average for year)
	Gold	Foreign Exchanges	Total	
Estonia: (kr.)				
1929	6	21	27	99.8
1930	7	16	23	99.6
1931	7	15	22	99.8
1932	15	5	20	100.2
1933	20	2	22	82.4
1934	28	4	32	62.1
1935	34	2	36	60.1
1936	34	9	43	60.8
1937	34	17	51	60.4
Latvia: (lats)				
1929	24	56	80	99.9
1930	24	41	65	100.0
1931	32	15	47	99.9
1932	36	12	48	100.0
1933	45	3	48	99.2
1934	46	4	50	98.3
1935	46	7	53	98.7
1936	77†	28	105	89.6‡
1937	77†	43	120	60.0
Lithuania: (litas)				
1929	35	78	113	99.7
1930	39	86	125	100.1
1931	50	33	83	100.2
1932	49	16	65	100.3
1933	52	15	67	100.1
1934	52	8	60	100.0
1935	36	18	54	100.0
1936	73	10	83	99.7
1937	79	6	85	99.4

* Gold holdings include gold held by the Government.

† After revaluation on the abandonment of the gold standard.

‡ Until the end of September the old parity of the lat was maintained in theory.

Estonia. Developments in recent years are shown in Table 52 on p. 178.¹ 652

The decline in ordinary revenue from the figure reached in 1928-9 was offset by a considerable reduction in ordinary expenditure effected during 1932. In that year salaries of officials were reduced by from 4 to 26 per cent., and large savings were made on repairs, renewals, and the purchase of materials. In spite of these measures,

¹ Most of the figures in the following tables and the information in this section are taken from the League of Nations: *Memorandum on Public Finance, 1928-1935*, Geneva, 1936-7, to which reference should be made for fuller details. Figures for Estonia in 1935-8 are taken from an article by the Assistant Minister for Economic Affairs, M. A. Keller, in *The Banker* for March 1936.

TABLE 52. *Budgetary Situation: Estonia*

(In million kroon)

Year	Ordinary Budget		Extraordinary Budget		Balance	Receipts from loans	Drafts on Treasury Balance
	Receipts	Expenditure	Receipts	Expenditure			
1928-9	86-6	75-8	3-6	15-0	+1-4	..	..
1929-30	86-5	83-4	4-8	12-3	-4-4	4-6	..
1930-1	83-5	83-0	1-2	14-0	-12-3	7-2	5-1
1931-2	76-8	73-4	2-0	13-7	-8-3	3-9	4-4
1932-3	62-9	60-6	3-2	7-9	-2-4	..	2-4
1933-4	63-6	61-1	1-6	4-1	..	..	..
1934-5	70-4	64-4	3-5	9-5	..	..	..
1935-6	79-5	79-4*	..	†	+0-1	..	..
1936-7	89-9	90-0*	‡	†	-0-1	..	-0-1
1937-8†	98-5*	§	§	§	§	§	§

* Including extraordinary budget.

† Estimates.

‡ Included in ordinary receipts.

† Included in ordinary expenditure.

§ Not available.

there remained a substantial deficit to be covered. As is shown above, this was met partly from loans. But, of the total borrowed in 1929-31, 7 millions represented the proceeds of the Swedish Match Loan, which was spent on the construction of railways, and partly accounts for the abnormally high level of extraordinary expenditure from 1928 to 1932. Apart from this, the State borrowed about 4 millions from the *Eesti Pank*. The remainder of the deficit was met out of the cash balance of the Treasury, which was consequently reduced from 22-8 millions at the end of 1928-9 to 2-0 millions at the end of 1933-4, though, owing to the better conditions prevailing since then, it has subsequently increased. At the same time, the total internal public debt has increased from 4-9 million kroon at the end of 1928-9 to 12-2 million kroon at the beginning of 1938.

The improvement since 1932-3 has been substantial, for in each year a balance has been obtained without recourse to borrowing or drawing on the Treasury. What is perhaps more remarkable is that the fall in the external value of the kroon since 1933 did not produce a greater increase in the kroon value of expenditure until 1936-7. In point of fact, expenditure had been reduced to such a degree by 1934-5 that, when an unexpectedly large increase in revenue led to a surplus, the two supplementary budgets were introduced during the year to revise the estimates in order that this surplus might be applied, as between the ordinary and extraordinary budgets, on repairs and renewals which had been neglected during the bad years.

The general impression created by these figures is that the public finances have now recovered from the crisis at the cost of a comparatively small increase in the public debt. Yet it must be remembered that recent economic policy, already referred to, has resulted in the

Estonia

Latvia

assuming of numerous contingent liabilities by the State outside the budget. The method usually consists of the creation of autonomous organizations such as the funds for the stabilization of prices of butter, bacon, and eggs. These funds are in theory self-supporting, the principle being to guarantee a fixed export price to the producer. So far, the difference between the internal and external prices of most of the commodities concerned has enabled these funds to be self-supporting in practice as well as in theory. But it is clear that in the event of a further period of depression, a heavy liability might fall on the State. No figures are available to show the proportion which these liabilities might assume. 652 ●

Latvia. In Latvia it is even more important than in Estonia to distinguish clearly between the financial position as shown in the budget figures, and that implied by the recent incursions of the State into the economic system.

So far as the budgetary situation is concerned, recent developments are shown in the following table:

TABLE 53. *Budgetary Situation: Latvia*

(In million lats)

Year	Ordinary Budget		Extraordinary Budget		Balance	Proceeds of Loans	Final Balance
	Receipts	Expenditure	Receipts	Expenditure			
1928-9	180.3	111.7	4.6	92.0	-18.8	25.0	+6.2
1929-30	181.4	120.3	9.7	63.0	+7.6	3.9	+11.7
1930-1	167.6	124.4	5.0	50.7	-2.5	..	-2.5
1931-2	117.7	118.7	10.4	33.6	-24.2	..	-24.2
1932-3	119.2	100.6	4.6	34.2	-11.2	6.3	-4.9
1933-4	121.4	99.0	2.2	28.3	-13.7	5.9	-7.8
1934-5	128.9	101.9	3.7	37.6	-6.9	6.6	-0.4
1935-6*	143.4	106.6	4.1	42.2	-4.5	4.6	..
1936-7*	152.0	133.1	6.2	26.4	-1.3	1.4	+0.1
1937-8*	166.3	143.6	12.6	37.3	..	..	..

* Estimates.

The years 1928-30 were to some extent abnormal, since the State was spending large sums on capital expenditure, which was largely covered out of the loan from the Swedish Match Trust, as already mentioned. The rapid decline in receipts after 1929-30 was met by a considerable reduction in ordinary expenditure, particularly on repairs and renewals, while in 1931-2 the salaries of State officials were reduced by 10 per cent. Yet, in spite of economies, the cost of the depression has been heavy. The balance of the Treasury reserve fund, which amounted to 86.5 million lats at the end of the year 1927-8, was reduced to 31.7 million lats by the end of 1934-5, and the funded internal debt—no external debt has been created by the

Latvia
Lithuania

652 State since 1930¹—increased from 0.6 million lats at the end of 1927–8 to 19.2 million at the end of 1935–6. The internal floating debt also has increased substantially, and amounted to 16.4 million lats at the end of 1935–6. To some extent this was due to the maintenance of the gold standard and the consequent necessity to take special measures to support the export trades. For example, subsidies for the promotion of agriculture, 1.0 million lats in 1929–30, amounted to 17.4 million lats in 1936–7 (estimates); and the total sum spent between the two years mentioned on this item was about 80 million lats.

There has been a considerable improvement since 1931–2, and, though complete figures are not available, it is probable that the budget for 1936–7 has closed with a surplus. But, as already mentioned, the analysis of the budgetary position can disclose no more than one side of the financial situation of the State. As in Estonia there are a number of extra-budgetary funds, which, though in theory self-supporting, may in practice involve the State in substantial liabilities. Moreover, the Latvian Government, unlike that of Estonia, has begun since 1935 to take a direct shareholding interest in a wide range of enterprises such as the *Latvijas Kredītbanka*, and even in individual industrial concerns. Full details as to the extent of these transactions are not available,² but some of their implications are clear. In times of prosperity, it is true, such undertakings may be a considerable source of revenue to the State. In a depression, however, it is possible that they will cease to make profits and, as the result, might have an unfavourable effect on the finances of the State. Thus, even from the purely financial point of view, the dangers of such a policy are obvious, particularly in a country like Latvia where there is no private capital market to which appeal can be made.

Lithuania. Developments during the last few years are summarized in the table opposite.

Though the decline of revenue, both ordinary and extraordinary, began later in Lithuania than in the other two countries, it was not much less serious. The decrease was to some extent met by reductions of expenditure, e.g. salaries of State officials were reduced by from 6 to 16 per cent. in 1932. Even so, there were considerable deficits, which could be met only by drafts on the Treasury's reserve fund. This fund was consequently reduced between the end of 1929 and the end of 1932 from 68.6 to 28.7 million lits, though owing to

¹ Except for that connected with the Keggum power station, for which see below p. 182.

² However, in the official Latvian *Monthly Bulletin of Statistics (Mēneša Biļetīns)* for September 1937, it is stated that since 1934 91.7 million lats had been invested by the State in various industrial and other concerns.

TABLE 54. *Budgetary Situation: Lithuania*

(In million lits)

Year	Ordinary Budget		Extraordinary Budget		Proceeds of loans	Balances
	Receipts	Expenditure	Receipts	Expenditure		
1928	278.7	224.6	3.6	55.7	..	+0.6
1929	296.1	238.6	3.1	41.4	..	+20.2
1930	303.0	243.5	11.2	77.1	..	-7.4
1931	311.8	250.7	3.3	84.6	..	-20.2
1932	252.2	230.6	13.8	57.6	..	-12.2
1933	228.5	206.6	20.7	43.0	1.0	+0.6
1934	235.9	205.6	21.7	46.2	..	+5.8
1935	218.9	208.2	41.5	68.7	*	-16.5
1936	245.9	220.5	56.9	67.2	*	+15.1
1937†	285.5	249.0	24.9	69.1	*	-7.7

* Included in extraordinary receipts.

† Provisional results.

the borrowing policy of the Government it has since slightly increased. The improvement of conditions after 1935 led to an improvement of revenue; and during 1936 the increase of revenue exceeded estimates by so large a figure that the estimates of expenditure were revised in an upward sense. But the needs of national defence, which had been somewhat neglected during the preceding years, induced the Government to issue a long-term internal loan of 15 million lits in December 1936, bearing interest at $4\frac{1}{2}$ per cent., and as the result of this and the budgetary deficits of the years of depression the internal debt increased from 0.8 million lits at the end of 1930 to 36.0 million at the end of 1936. A further increase took place in the spring of 1937 when powers were granted to the Government to issue a five years' loan of 20 million lits.

Thus, although the depression has led to a decrease in the Treasury's reserves and an increase in the internal debt, the latter is still comparatively small, and its cost to the budget is almost negligible. Unlike that of the other two countries, the Lithuanian financial system is not overburdened with a large number of extra-budgetary organizations, though it is true that the co-operative system is, in the last resort, dependent on the State in Lithuania as in Estonia and Latvia. One of the chief problems in Lithuanian public finance arises out of the maintenance of the gold standard and the consequent necessity for the Government to subsidize exports directly or indirectly. In the revised budget of 1936, for example, 20 million lits were allocated to the Ministry of Agriculture for the maintenance of agricultural prices. This support of prices arises largely out of the maintenance of the gold standard and is to some extent independent of world price movements. The total of the public funds which has to be spent in this way each year cannot be accurately ascertained,

- 652 but it is probably large, and it is clear that there can be no substantial decrease so long as the Government continues to pursue its present exchange policy.

3. FOREIGN DEBT

457 Since 1930 no long-term loans have been contracted abroad by these States, and in all cases the service of existing loans, except that of War and relief debts,¹ has been maintained.

City of Riga Loan. The principal development during the period was the recognition by the Municipality of Riga of its responsibility for a loan contracted in London before the War, which did something to rehabilitate Latvia's credit. The total nominal amount of this loan was originally £1,322,700, bearing interest at $4\frac{1}{2}$ per cent., and the whole issue was made in London in 1914 when Riga was a part of the Russian Empire. Service was maintained up to 1917, by which time £1,281,800 was outstanding. After Latvia was declared an independent republic, repeated efforts were made by the British bondholders to induce the municipality to recognize its liability for this loan. Their efforts were unsuccessful until July 1934, when an agreement was concluded, shortly after the Anglo-Latvian commercial treaty was signed, on the following basis. Arrears of interest were to be cancelled, the ultimate date of redemption was postponed from 1954 to 1984, the principal amount of each bond was reduced by 40 per cent., and the interest by $\frac{1}{2}$ per cent. These terms applied only to bondholders who, at the date of settlement, were not Latvian citizens, holders of Nansen passports, or persons without nationality. The Latvian Government at the same time undertook to provide adequate guarantees for the carrying out of the arrangements and to impose no restrictions upon the transfer of service. The total nominal value of bonds recognized under the agreement was £1,217,200, but, owing to the writing down of the capital amount, the total nominal liability assumed by the municipality was £730,320. The only other important obligation incurred abroad during these years arose out of a contract concluded in August 1936 between the Latvian Government and a Swedish firm for the building of a power station at Keggum, on the Daugava near Riga.²

Reduction of Indebtedness. Apart from this, the chief changes can be seen from the table opposite which gives the latest figures available.

¹ See above, p. 169.

² According to the *Ost Express* of February 25, 1938, the total cost of this undertaking is estimated at about 53 million lats, of which about 14.4 million have been provided in the form of a credit of 11 million Swedish krona by the Swedish contractors. Of the balance, 33.6 million lats was raised by an internal State loan in February 1938.

TABLE 55. Gross Foreign Indebtedness

(In million Swiss francs)

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At end of:	Estonia			Latvia		Lithuania	
	1930	1935	1936	1930	1935	1930	1934
1. Intergovernmental debt	114.0	67.5	67.6	85.1	53.7	36.2	22.6
2. Other Government and municipal debt	51.7	23.3	26.9	31.1	29.5	37.7	28.0
3. Foreign long-term investments in banks, industry, &c.	45.8	23.3	22.1	104.6	82.9	33.6	43.6
4. Private short-term debt and other debt	?	0.9	3.8	137.3	106.7	15.9	10.6
Total	(311.5)	115.0	120.6	358.3	273.8	123.4	104.8

The large reduction in intergovernmental debt is due to the depreciation of the dollar and sterling, which accounts also for much of the decrease in the other items, especially Government and municipal debt. The small decrease in Latvia's Government and municipal debt is due to the inclusion, in 1935, of the Riga debt already mentioned. It remains to be added that neither Estonia nor Latvia has had the full benefit of this decrease in their foreign indebtedness, owing to the depreciation of their respective currencies. Yet the amount of foreign debt is still relatively small, and so far as can be seen the service imposes no heavy burden on any of the three States.

4. THE BANKING SYSTEM, 1931-7

The crisis of 1931 had a severe effect upon the entire banking system. The commercial banks, which depended largely upon the financing of foreign trade, were the most seriously affected, owing to the general decrease of exports and imports, and especially to the exchange restrictions, which generally had the effect of centralizing dealings in foreign currency in the Central Banks or their nominees, while, as was seen, a large number of foreign credits made available to commercial banks in these countries by their foreign correspondents was withdrawn during 1930 and 1931. Mortgage banks, also, suffered severely through the decline in agricultural prices, which made it difficult, if not impossible, for peasants to meet the service of loans contracted when prices were considerably higher; and, as already noted, measures had to be taken to relieve such debtors in Estonia and Latvia. Finally, the general reduction in economic activity was inevitably reflected in the co-operative system, though the effect of the depression was less evident in this case than elsewhere.

The general recovery of the economic situation in all three countries has naturally been followed by an improvement in the position of

453 the banking system, particularly in that of the commercial banks.
458 In the latter case the recovery has been accompanied, in Latvia and
● 652 Estonia, by developments which are of some interest, and which are
noted below. For reasons of space it is impossible to describe the
developments which have taken place during the last few years in
the other branches of the banking system. This omission is not of
great importance, since the co-operative system, for example, re-
mains, in principle at any rate, what it was before the depression.
However, the difficulties encountered by the commercial banks
since 1930 have somewhat increased the part which it plays in
financing the internal distribution and export of agricultural goods,
and even in the import of agricultural machinery and artificial
manure. A further development outside the realm of commercial
banking is the increase, since 1931, of deposits with Government
savings banks, perhaps as a consequence of the lack of confidence,
at any rate until the last year or two, in the commercial banks.
Finally, it should be said that no complete statistics are available
in a comparable form to show developments in the banking system
of the Baltic States as a whole. A table showing the movement of
deposits since 1929 is given on page 187.

Latvia. The most remarkable developments in commercial banking
have taken place in Latvia. In order to explain these developments
it is necessary to begin with the crisis of 1931. The German banking
crash in July of that year led to an almost complete collapse of
Latvia's commercial banking system. German withdrawals of credit
and deposits had been particularly severe, and in the first fortnight
of that month two of the largest commercial banks, which had close
relations with the German banking system, stopped payment. The
prevailing uncertainty led to conditions bordering on panic in Latvia,
and there was a large number of domestic withdrawals. It finally
became necessary for the Government, on July 21, to authorize the
banks to restrict withdrawals of deposits to 5 per cent. of the total
deposits per week, a figure which was subsequently reduced to
2½ per cent. This regulation was kept in force until the latter part
of 1932, and only one of the private banks did not take advantage
of it, but continued to pay out deposits in full during the whole
period. In this bank a considerable amount of British capital was
invested.

But, though this measure checked the further progress of the
credit crisis, it naturally did not promote the return of confidence
in the commercial banking system. For two years, as can be seen
from the table at the end of this section, deposits with the joint stock
and municipal and mutual credit banks remained at approximately
the level to which they had fallen by the end of 1931, i.e. about half

that of the peak year, 1929. Meanwhile, the banks were not able to improve their position through any increase in economic activity, for such an increase was prevented by the monetary policy pursued by the Government, at any rate until 1935.¹

At this stage the State, now converted to totalitarian principles, intervened with a programme of reform. The instrument of this reform was the *Latvijas Kredītbanka*, founded by the Government in April 1935 with the comparatively large capital of 15 million lats.² The bank is directly controlled by the Ministry of Finance, and is empowered by decree to take over other banks or industrial concerns, at an arbitrary valuation from which there is no appeal, if the Minister of Finance is satisfied that they are in difficulties. This institution proceeded to put into effect a programme of compulsory amalgamation by taking over or liquidating a large number of commercial banks, in some of which a considerable amount of foreign capital was invested and, at the same time, to carry on ordinary banking business in competition with the few banks which remained. Thus, the bank began to acquire for itself a position in the financial system very similar to that of a monopoly.³

During 1936 and 1937 the importance of the *Latvijas Kredītbanka* has been still further extended. The bank has begun to take a direct shareholding interest in a number of important industrial concerns of a very varied nature, and thus to acquire a 'sphere of interest' in industry on behalf of the Government. While the Government has stopped short of the nationalization of all private interests, the powers possessed by the *Kredītbanka* are so large, and are exercised so arbitrarily, that considerable anxiety exists, not only in Latvia itself, but also abroad. Reassuring speeches, however, were made by the authorities during the first few months of 1937, which have done something to allay these feelings.⁴

Estonia. The effect of the crisis of 1931 on the commercial banks in Estonia was less severe than in Latvia, for, though the volume of credits withdrawn by foreign correspondents in 1931 was large, the connexion with the German banking system was perhaps less close. At all events, there was no collapse of the banking system similar to that which took place in Latvia, and drastic reconstructions were

¹ See above, pp. 173-4.

² This was increased to 20 million lats in 1936.

³ A similar policy was adopted with regard to insurance in Latvia. A law was passed in October 1934 granting the State Insurance Department of the Ministry of Finance wide powers over private insurance companies, requiring them to pay 10 per cent. of their premiums to the Department, and requiring fire policies to be reinsured with the Department to the extent of 25 per cent. Foreign insurance companies and their agents were forbidden to operate in Latvia. See D.O.T.: *Economic Conditions in Latvia, January 1935*, publ. 1935, pp. 7-8.

⁴ The effect of recent developments in Latvian banking is discussed in the *Economist* of March 14, 1936, and January 9, 1937.

Estonia
Lithuania

453 postponed until 1934, when one of the largest commercial banks was
458 finally compelled to write down its capital by a substantial propor-
652 tion. Similarly, the direct part played by the State in dealing with
the banking system was very much smaller, though mention should
be made of the introduction of a national credit law in March
1932, which supplemented the old Russian credit statutes hitherto
in force.

The abandonment of the gold standard was followed by a considerable improvement in the banking position as a whole, and by 1935 most of the more important units of the system had completely recovered from the effects of the depression. The further growth of activity since 1935, and in particular the increase of industrialization, led to a considerable expansion of credit. Its extent may be judged from the fact that on December 1, 1937¹, the loans and discounts of 13 joint stock banks and the 25 principal co-operative banks stood at 97.2 mill. kr., as compared with 73.3 mill. kr. at the end of 1932. There was a similar movement also in the loans made by the Central Bank. This expansion created a serious problem for the Estonian credit system. For, since the middle of 1936, there had been a number of indications suggesting that economic activity had reached something like a boom level. In industry, as has been seen, there had actually been a shortage of labour, which had begun to attract workers from agriculture. The note circulation, also, had expanded—from 32.1 million kroon at the end of 1932 to 49.1 millions at the end of 1937—though there had also been an increase in the gold cover. But, as was shown, prices also had risen very rapidly. In these circumstances the continuous expansion of credit by the banking system aroused some apprehension, especially as there was a large import surplus both in 1936 and 1937. However, although by March 1938 no measures had been taken to restrict credit, there were signs that the authorities realized the dangers of the situation and were attempting to control the volume of capital outlay in building and industry.²

Lithuania. Developments in the commercial banking system in Lithuania were of less importance than in the other two countries. As already noted, the crisis of 1931 did not lead to a flight from the currency or to foreign withdrawals of capital on any great scale. There was, it is true, a number of domestic withdrawals in 1931, from which the commercial banks were just beginning to recover when the events of 1935 referred to above³ took place. Even so, the

¹ Subsequent figures are not comparable.

² It is of interest, however, in this connexion that in the spring of 1938 a proposal was being discussed in the Estonian press, according to the *Revalische Zeitung* of March 5, 1938, for increasing the capital of the *Easti Pank*. Since then little more has been heard of the proposal.

³ See p. 175.

abnormal export of capital in that year was arranged without any really serious effect on the banks, and there were no important failures. Since 1935 there has been a steady improvement.

153
488
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TABLE 56. *Movement of Deposits and Current Accounts with Commercial and Savings Banks*

(In millions of national currency)

At end of	I. Commercial Banks (deposits and current accounts)			II. Savings Banks (deposits only)		
	Estonia* (all commercial and principal co-operative banks)	Latvia (joint stock banks and mutual and municipal credit assoc.)	Lithuania (commercial banks and mutual credit assoc.)	Estonia (State savings bank)	Latvia (postal savings bank)	Lithuania* (State savings institution)
1929	65	92	96	3	4	2
1930	73	99	130	4	7	11
1931	60	49	140	5	8	25
1932	51	49	143	5	13	34
1933	51	51	149	6	20	39
1934	65	63	157	8	24	43
1935	74	74	155	10	49	43
1936	93	117	170	15	61	53
1937	103	173	204	10	79	60

* January 1 of following year.

IV. CONCLUSION

It has been seen that in Estonia and, superficially at any rate, in Latvia, currency manipulation has been followed by a considerable degree of recovery, while in Lithuania the position has substantially improved in the face of that country's refusal to follow their example. In spite of the fall of prices during the first half of 1938, all these countries were still enjoying a measure of prosperity greater than at any time since 1931. This recovery has been based, broadly speaking, on the gradual expansion of exports to the United Kingdom, the higher level of world prices as compared with that of the crisis years, and, so far as the internal position is concerned, on the policy of self-sufficiency dictated by the lack of foreign exchange in the years of the depression. It remains to examine how far these elements can be considered to be of a permanent nature.

It will first be seen that the case of Lithuania differs somewhat from that of the other two countries. In Lithuania the productive system has remained essentially very much what it was before the crisis of 1931. Provided, therefore, that there is no fundamental change in her economic policy, it is reasonable to suppose that Lithuania will continue to exchange agricultural produce for manufactured articles, and that the index of her prosperity will continue